RAND

The Economic Dimensions of National Security

C. R. Neu, Charles Wolf, Jr.

Prepared for the
Office of the Secretary of Defense

National Defense
Research Institute

Approved for public release; distribution unlimited

The end of the Cold War has brought a reduction in the direct military and political threats facing the United States. As these threats have receded, the attention of both the U.S. policy community and the general public has turned to other kinds of developments and circumstances that can affect the ability of the U.S. population to pursue life, liberty, happiness, and prosperity on their own terms. In particular, recent years have seen increased interest in U.S. "economic security"—in the ability of the United States to protect its own economic prosperity and to shape the international economic environment to the advantage of most of the U.S. population. Increasing attention is being paid to defining U.S. economic interests and to identifying potential threats to these interests. Increasing attention is also being paid to the usefulness of economic instruments as substitutes for or complements to military and political means of achieving traditional U.S. national-security and foreign-policy objectives. Increasingly, the first responses to national-security and foreign-policy problems are economic: trade restrictions, embargoes, freezing of financial assets, and so on. This new emphasis on economic means for achieving international ends raises new questions about what constitutes national "economic power" and how such power can and should be exercised.

WHAT IS ECONOMIC SECURITY?

Economic security is the ability to protect or to advance U.S. economic interests in the face of events, developments, or actions that may threaten or block these interests. These challenges or obstacles may be foreign or domestic in origin, intentional or accidental, and the consequences of human or of natural forces. Further, economic security depends on the United States' ability to shape the international economic environment to its liking—for example, by playing a major role in establishing the rules that govern international economic relations and by using economic means to influence the policies (economic and otherwise) of other countries. Economic security also requires possessing the material resources to fend off noneconomic challenges. Among other things, one must have the economic wherewithal to support an adequate military.

Certainly, economic prosperity as usually defined—economic growth, full employment, low inflation, high levels of investment, improvements in productivity, etc.—will contribute to economic security. But economic security requires more than just maximizing current economic prosperity. The objective of economic security is to reduce uncertainty about continued economic well-being. Sometimes it will be wise to sacrifice some current prosperity to make that of the future more stable, more certain, or less subject to loss.

PURSUING ECONOMIC SECURITY

Much discussion of economic security is couched in terms of international competition and comparisons: Which economies are biggest, most productive, most innovative? Who controls important economic assets? What firms are dominant in particular markets? This focus on competition and comparisons is useful in identifying at least some policies that will enhance U.S. economic security.

The Importance of Relative Size

Few would contend that U.S interests would have been better served if the U.S. economy stood today in the same relation to other economies as it did in, say, 1950—if, that is, the postwar reconstruction of Europe and Asia or economic development efforts elsewhere had been less successful. The United States also has an interest in promoting economic reform and growth in the formerly socialist countries. Nonetheless, neither U.S. nor world interests will be served if U.S. economic growth lags behind that of the rest of the industrialized world.

Nations with large economies naturally enjoy greater influence in establishing the rules that govern international economic relations. Dominant in nearly every dimension of economic activity in the early postwar era, the United States played a key role in establishing the international economic institutions and arrangements that still shape international economic activity. By and large, the United States has been a benevolent and effective maker of international economic rules, and one might well wonder who will fill this role if the United States no longer does. To some observers, it is no coincidence that international cooperation in economic matters has become more problematic in the latter part of the postwar era as U.S. economic dominance has become less pronounced.

In recent years, investment as a share of total output has been lower in the United States than in most other industrialized countries. If this pattern persists, economic growth in the United States will almost certainly lag behind growth elsewhere in the world. The relative size of the U.S. economy—and with it U.S. influence in international economic matters—will decrease. The effective pursuit of U.S. economic security, and probably of broader, international economic security as well, will require U.S. economic policies that restrain consumption, encourage saving, and provide incentives for investment.

Support for Specific Industries

Beyond measures to raise the general level of investment in the United States, interest is growing in direct government support for specific "strategic" or "critical" industries. Allegedly, such support will enhance U.S. economic security by promoting the growth of industries that will particularly contribute to U.S. economic welfare—by generating high-paying jobs, higher-than-usual profits, or "spinoffs" beneficial to other industries. Further, such support may prove an effective counter to efforts by foreign governments to boost their own domestic activity in the same industries.

As a theoretical principle, the possibility that direct government support of particular industries can enhance overall national welfare is well established. But support for one industry must necessarily come at the expense of other industries or interests (subsidies paid to a favored industry, for example, must be financed by someone), and there is considerable debate today over whether the potential benefits of such support are sufficient to outweigh the inevitable costs. There is also considerable suspicion over governments' ability to identify opportunities for welfare-enhancing industrial support objectively and to provide that support effectively. We can have little confidence that increased governmental efforts to support particular industries will prove beneficial.

Without question, other nations aggressively support particular industries, and U.S. firms and U.S. workers suffer as a consequence. This fact alone, though, is not sufficient to justify similar support by the U.S. government. In some cases, foreign industrial policies may benefit U.S. consumers, and a careful (and inevitably political) balancing of consumers' gains against producers' losses will be required. Even when it seems clear that foreign actions are detrimental to U.S. interests, the best U.S. response is not necessarily to provide counterbalancing help to the U.S. industry most directly affected by foreign subsidies. In some cases, it may be better for the United States to retaliate in some other area, seeking not simply to balance or cancel out the effects of a foreign subsidy but rather to bring about the removal of the foreign subsidy that caused the problem in the first place. As in military affairs, capitalizing on one's own strengths or exploiting an opponent's weaknesses may prove a more effective counter than trying to meet an opponent's challenge head-on.

Maintaining an Adequate Military

Military strength requires an economic underpinning, and a part of economic security is maintaining a level of general economic output that allows diversion of adequate resources to military uses.

At a more micro level, economic security will also require maintenance of the industrial capability to design and to produce successive generations of technologically sophisticated weapons. It is only in the last few years, as defense spending has been sharply reduced, that serious attention has been turned to understanding what industrial capabilities are truly essential to this task and what will be required to maintain these capabilities. Efforts to date to identify particular technologies as "critical" for defense purposes have not

yielded much in the way of operational policies for managing the defense industrial base. General policies aimed at narrowing the gap between military and commercial technology development efforts and at attracting additional firms into supplying military needs are likely to be more productive than efforts to preserve particular firms or to advance particular technologies.

As defense spending declines further, it will probably also be wise to make greater use of foreign suppliers to meet U.S. military needs. For some military needs, of course, it will never be wise to rely on foreign sourcing. But for many purposes, developing sources of supply in friendly nations may reduce Department of Defense (DoD) dependency on domestic monopolists and create additional opportunities for expanded production if it should ever become necessary to rebuild U.S. military forces.

Foreign Investment in the United States

For the most part, fears about foreign direct investment in the United States appear to be unfounded. Although foreign interests may gain control of significant commercial or industrial assets in the United States through direct investment, it is far from obvious who gains effective leverage over whom as a result of such transactions. Fixed assets in the United States cannot be easily withdrawn by a foreign owner, and a foreign owner of U.S. assets is in a very real sense hostage to U.S. laws and policies. Although research on the subject is far from complete, there seems little evidence to date that the behavior of foreign-owned firms operating in the United States differs from that of similar U.S.-owned firms—at least not in ways that can be viewed as contrary to U.S. interests. Rather than being dangerous, foreign investment can bring real benefits to the U.S. economy. To the extent that foreign investment results in the creation of new fixed assets in the United States or the introduction to this country of superior foreign methods or processes, employment opportunities for and the productivity of U.S. workers is likely to be increased.

A BROADER VIEW OF ECONOMIC SECURITY

True economic security will require more than just making sure that the U.S. economy is bigger, more robust, or faster growing than other focused on closing gaps in the regulation of international banking activity, reducing the vulnerability of electronic clearing arrangements (the so-called financial wires) to intentional or accidental disruption, strengthening protection of intellectual property rights, establishing workable enforcement mechanisms for international trade agreements, and devising a framework for effective international competition (anti-trust) policy.

An Equitable Distribution of Domestic Income

True national security—of either the military or the economic variety—requires a unified populace with a common understanding of national interests and capable of standing together in the face of foreign challenges. This kind of unity will be promoted by a domestic distribution of income and economic well-being that is perceived to be broadly fair. Although the continuing integration of the U.S. economy into the broader international economy has unquestionably benefited most of the U.S. population, lower-skilled U.S. workers increasingly find themselves in competition with an enormous pool of low-skilled and low-paid labor in the rest of the world. If these workers are left out of the general prosperity, U.S. economic security will be undermined. Efforts to raise the skill levels and hence the productivity of such workers should be a principal aim of U.S. economic security policies. Unfortunately, few efforts to raise the productivity of adult workers have proven successful, and revamping the U.S. educational system to produce a new generation of highly productive workers—even if anyone knew how to effect such a transformation—will produce results only years in the future. While waiting for such efforts to bear fruit, we may wish to rethink the conventional wisdom that economic security is advanced by promoting "high-tech" industries. A wiser strategy might be to work to increase productivity, and thus wages, in industries that can provide jobs, possibly of a distinctly "low-tech" variety, for those U.S. workers who are most sorely pressed by low-wage foreign competition.

ECONOMIC POWER

Thus far, we have focused on one aspect of economic security: the broad national-security consequences of economic policies. The DoD is, organizationally, a secondary player in this arena. But

"economic security" also has another dimension: the economic consequences of national security policies. Defense policies are more directly involved here, and the DoD and the National Security Council are dominant players in this arena.

The economic consequences of national security policies have two components: first, the ways in which military instruments may be used to generate economic effects and second, ways in which economic instruments can be used to substitute for, or to complement, military instruments in pursuit of security objectives.

Using Defense Resources for Economic Purposes

The first component focuses on how economic considerations can affect the management, use and allocation of resources earmarked for defense purposes. For example, can military research and development programs be configured in ways that make them more likely to generate commercially valuable "spin-offs"? Can military resources—troops, airlift, logistics, engineering and medical services, for example—be more effectively used to support nontraditional objectives—emergency assistance, economic development, or nation-building perhaps—without significantly diminishing their combat effectiveness? Can U.S. arms production and export policies be structured so as to discourage production or acquisition of particularly dangerous weapons by other nations? Can extensive U.S. intelligence assets be effectively and appropriately used for economic purposes?

Using Economic Instruments for Defense Purposes

The second component involves the potential use of economic instruments as substitutes for, or complements of, military instruments. As elements of security policy, economic instruments can influence the behavior of other countries by conferring economic benefits or imposing economic costs, or by displaying a credible capacity to do so. Foreign economic as well as military aid, technical assistance, and most-favored nation status can be used to confer such benefits. And economic sanctions—embargoes, freezing of financial assets, restricting access to U.S. markets, or heavily taxing such access—can be used to impose economic costs. When economic instruments are used as adjuncts of security policy, they can be compared to military instruments. Military instruments also provide a means of influencing behavior in the international arena by deterrence or compellence: that is, by using force, or credibly threatening to use it, to dissuade other countries from using force, or by using force to coerce, preempt, or repel their attempts to use it.

There are opportunities, which are sometimes overlooked, for using economic instruments—whether as "carrots" or "sticks"—to enhance the effectiveness of military instruments in the pursuit of security objectives. However, government entities that control the levers of economic power are not always those that are used to thinking in military or foreign-policy terms. Careful coordination of economic and military instruments for the effective employment of both will require mechanisms for policy planning and interagency cooperation that are infrequently exercised today.

ACKNOWLEDGMENTS

The authors wish to express appreciation for the knowledgeable, valuable, and extensive comments on an earlier draft by RAND colleagues Michael Kennedy and Julia Lowell, as the formal reviewers of this report. Their suggestions, as well as the equally valuable ones provided informally to us by Harold Brown, have contributed measurably to improving the report's quality.